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THE CHANGING PARADIGM OF DEBT

KATHRYN R. HEIDT*

I. INTRODUCTION

The Bankruptcy Code is fifteen years old and fourteen years out of date. The Bankruptcy Code went into effect in 1979. A year later, in 1980, the most comprehensive environmental statute ever enacted to provide for cleanup of sites contaminated with toxic substances went into effect—the Comprehensive Environmental, Response, Compensation and Liability Act (CERCLA, or alternatively, Superfund). Even though the Bankruptcy Code and Superfund were considered by Congress at roughly the same time, they are not well coordinated. The obligations created by Superfund do not fit neatly into the current bankruptcy system.

The environmental laws are not the only source of new forms of obligations, however. Mass torts and products liability obligations are also difficult to deal with in bankruptcy. Tort law continues to develop, creating both new forms of liability¹ and new methods of assessing liability.² As the shapes of obligations and liabilities continue to develop, change, and grow more complex, the bankruptcy system must keep pace. In order to remain vital, the bankruptcy system must identify which

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1. One new form of tort is liability for increased risk of injury, which allows victims to recover when a product or an act of wrongdoing increases their likelihood of suffering an injury or contracting a disease. Potential victims may recover even though they have not yet suffered an injury and may never suffer an injury. See, e.g., *Petriello v. Kalman*, 576 A.2d 474 (Conn. 1990); *Sterling v. Velsicol Chem. Corp.*, 647 F. Supp. 303, 321-22 (W.D. Tenn. 1987). For discussions of this new tort liability, see Kenneth S. Abraham, *What is a Tort Claim? An Interpretation of Contemporary Tort Reform*, 51 MD. L. REV. 172, 181-86 (1992); Kristen Chapin, Note, *Toxic Torts, Public Health Data, and the Evolving Common Law: Compensation for Increased Risk of Future Injury*, 13 J. ENERGY NAT. RESOURCES & ENVTL. L. 129 (1993).

2. New methods of imposing liability include apportioning liability based on the defendant's market share. This approach was adopted in the cases brought by the daughters of women who had taken DES while pregnant in the 1950s. See, e.g., *Sindell v. Abbott Lab.*, 607 P.2d 924 (Cal. 1980) (imposing liability based on the defendants' share of the DES market). The approach has also been used in some asbestos cases. See, e.g., *Hardy v. Johns-Manville Sales Corp.*, 509 F. Supp. 1353 (E.D. Tex. 1981).

obligations it will take into account in a proceeding.

In this paper I suggest that the current paradigm of debt used in bankruptcy law is outmoded. Products liability and mass tort bankruptcies were the first wave of cases with obligations that did not fit neatly into the existing model of debt. Environmental obligations were next—obligations based on Superfund and other federal and state environmental laws. Because Congress did not focus on these new obligations when it enacted the Bankruptcy Code, and because these obligations do not fit well within the bankruptcy system, I argue that we need a new model of obligation that will take into account current and future forms of liability.

The characteristics to be included in the new model of debt or obligation depend largely on one's view of what bankruptcy does and should do. I conclude, first, that steps can be taken outside of bankruptcy to encourage the proper internalization of costs, with the further aim of generally reducing the harms associated with problems such as mass tort liability and large-scale environmental contamination. However, since it is impossible to avoid all future injuries through planning and internalization, I conclude that (1) obligations based solely on past acts of the debtor should be subject to the bankruptcy system, but (2) new postbankruptcy obligations should not be discharged even if they are based on prebankruptcy acts. The debtor must meet those postbankruptcy obligations.

This solution is based on two policy ideals that I consider fundamental to bankruptcy law. First, bankruptcy should separate the past from the future. Second, similar creditors should receive similar treatment. The result is also consistent with the well-accepted policy goal of providing a "fresh start" to the honest individual debtor.

Although bankruptcy policy in general, and Chapter 11 of the Bankruptcy Code in particular, have been the subject of intense debate,³ I start from

3. Some scholars have questioned the validity of Chapter 11 or called for its complete repeal. Others defend it, at least until a better alternative is suggested, and many suggest ways in which it can be improved. In addition to the other articles printed in this Symposium issue, the following articles are examples of the continuing debate: Douglas G. Baird, *A World Without Bankruptcy*, LAW & CONTEMP. PROBS., Spring 1987, at 173; Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. LEGAL STUD. 127 (1986); Lucian A. Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775 (1988); Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043 (1992); Karen Gross, *Re-Vision of the Bankruptcy System: New Images of Individual Debtors*, 88 MICH. L. REV. 1506 (1990); Kathryn R. Heidt, *Interest Under Section 506(b) of the Bankruptcy Code, The Right, The Rate, and the Relationship to Bankruptcy Policy*, 1991 UTAH L. REV. 361, 382-86; THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* (1986) [hereinafter JACKSON, LOGIC]; Donald R. Korobkin, *Contractarianism and the Normative Foundations of Bankruptcy Law*, 71 TEX. L. REV. 541 (1993); Lynn M. LoPucki, *The*

the assumption that we shall continue to have a bankruptcy system that includes a discharge of debts for individual debtors and for business debtors who reorganize. Despite the ongoing disagreement over the effectiveness of the current system, Congress is not likely to repeal Chapter 11 altogether,⁴ nor is there reason to believe that Chapter 7 or Chapter 13 will be repealed. Bankruptcy has become a part of our legal landscape. Before we can address whether bankruptcy is efficient, whether it is better replaced by markets, or some of the other questions raised in this Symposium issue, we need to resolve a more fundamental question: What obligations should be taken into account in the bankruptcy process?⁵

Part II briefly describes the traditional model of debt and explains how it is incorporated into the current Bankruptcy Code. Part III explains how the new forms of liability, which I call "extraordinary liabilities," differ from the traditional model of debt. Part IV explores how the new forms of obligations have been treated under the Bankruptcy Code and shows that these obligations do not fit well into the current paradigm. Part V suggests a solution to meet the demands of the changing paradigm of obligation.

Trouble With Chapter 11, 1993 WIS. L. REV. 729; Lynn M. LoPucki & William C. Whitford, *Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125 (1990); Mark J. Roe, *Bankruptcy and Debt: A New Model for Corporate Reorganization*, 83 COLUM. L. REV. 527 (1983); David A. Skeel, Jr., *Markets, Courts, and the Brave New World of Bankruptcy Theory*, 1993 WIS. L. REV. 465; TERESA SULLIVAN ET AL., *AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA* (1989); Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775 (1987).

4. For one look at the politics of Chapter 11 repeal, see Skeel, *supra* note 3, at 494-509.

5. The paradigm of debt directly affects the conclusions of some of those who have attacked, supported, or argued for reform of Chapter 11. To take just one example, the Bradley and Rosenzweig critique of Chapter 11 rests on questionable ground when one considers the new forms of liability and the bankruptcy paradigm of debt. In their study, Bradley and Rosenzweig looked at over 160 companies that attempted to reorganize under the old Bankruptcy Act and compared them to a similar number that attempted to reorganize under the Bankruptcy Code. See Bradley & Rosenzweig, *supra* note 3, at 1058-75. The Act cases involved debts that, for the most part, fit the traditional model. *Id.* But several of the Code cases, such as *Johns-Manville*, involved obligations that did not fit the traditional model. *Id.* Without more information it is impossible to say whether these companies driven, at least in part, into bankruptcy by the new forms of liability affect the conclusions drawn in the article. Although the LoPucki and Whitford study included only a few bankruptcies that involved mass tort or environmental problems, see LoPucki & Whitford, *supra* note 3, I think it is safe to say that the last few years show a significant increase in the number of cases involving such obligations. Whether this calls into question the future implications of those studies is itself a matter for further study. Elizabeth Warren, Jay Westbrook, and Teresa Sullivan will hopefully gather data in their proposed five-year study described in this Symposium issue. See Elizabeth Warren & Jay Westbrook, *Searching for Reorganization Realities*, 72 WASH. U. L.Q. 1257 (1994); Teresa A. Sullivan, *Methodological Realities: Social Science Methods and Business Reorganizations*, 72 WASH. U. L.Q. 1291 (1994). Suggestions for reform based on statistics from the distant past (old Act cases) are not valid for all contemporary bankruptcy cases.

II. THE TRADITIONAL BANKRUPTCY DEBT PARADIGM

Our current bankruptcy system is based on an outdated paradigm of debt. The paradigm is centered around the concept of a traditional debt: Jack owes Jill \$100. This debt model has two characteristics: (1) it is an obligation to pay *money* and (2) it arises out of a past transaction. In the example, Jack owes Jill money. The obligation prototypically arose sometime in the past when Jack borrowed money from Jill.⁶

Over time, the traditional concept of debt has been expanded to include not only consensual obligations but also obligations that arise from nonconsensual transactions. Thus, if Jack drove his car through a red light and injured Jill, Jack's liability would also fall comfortably within the traditional concept of debt. As new forms of liability were invented or old forms were expanded (e.g., products liability), these additional liabilities were also brought within the bankruptcy umbrella.⁷ For some time, bankruptcy has provided for the discharge of both consensual and nonconsensual debts.

By 1978, when the Bankruptcy Code was enacted, dischargeable debts under the soon-to-be-supplanted Bankruptcy Act included all of the traditional consensual and nonconsensual obligations.⁸ In the new Code, Congress further expanded the class of obligations covered by the bankruptcy system to include debts that were still contingent, unliquidated,

6. Historically, bankruptcy law was more limited than today—it discharged only the debts of merchants and business people. Even the famous passage from the Supreme Court case widely cited as recognizing an individual's right to a fresh start under the bankruptcy law refers to business misfortunes: "One of the primary purposes of the Bankruptcy Act is to 'relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.'" *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (quoting *Williams v. U.S. Fidelity & Guar. Co.*, 236 U.S. 549, 554-55 (1915)).

7. Expanding bankruptcy to include ordinary individuals, not just those engaged in business, was a conscious choice made by Congress. But the expansion of dischargeable obligations to include nonconsensual debts may have been an historical accident. The same may be true of the practice of giving tort creditors the same priority as unsecured creditors. As tort liability developed in the mid-nineteenth century, it may simply have been lumped together with other general unsecured liabilities without express consideration.

8. Although some have argued that tort creditors should be given priority over other creditors, see Kathryn R. Heidt, *Cleaning Up Your Act: Efficiency Considerations in the Battle for the Debtor's Assets in Toxic Waste Bankruptcies*, 40 RUTGERS L. REV. 819 (1988), Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 VA. L. REV. (forthcoming 1994), Christopher M.E. Painter, Note, *Tort Creditor Priority in the Secured Credit System: Asbestos Times, The Worst of Times*, 36 STAN. L. REV. 1045 (1984), there has been no real effort to separate nonconsensual creditors from consensual creditors inside or outside of bankruptcy.

or disputed.⁹ However, this expansion was limited to obligations that closely tracked the traditional concept of debt: money obligations that are based on past acts. Specifically, the Code requires that, in order to be subject to the bankruptcy process and to be dischargeable, an obligation (1) must be a "claim" and (2) must "arise" before a certain time.¹⁰

A. Defining a "Claim"

First, the obligation must fit within the definition of "claim." One who holds a claim participates in the bankruptcy proceeding and shares in the bankruptcy distribution. In a Chapter 11 proceeding, those with claims can vote on a plan of reorganization.¹¹ They have certain rights and are afforded certain protections in the proceeding and the resulting distribution.¹² In the case of a Chapter 7 bankruptcy proceeding, those who hold a claim share in the distribution.¹³ Only obligations that are claims can

9. See *infra* note 16 for the Bankruptcy Code's definition of "claim." In general, Congress intended the definitions of "debt" and "claim" to be "expansive." *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 435 U.S. 552, 558 (1990). The obligation no longer had to be "provable" as it had under the old Bankruptcy Act. Obligations that had been challenged as not sufficiently certain or provable to be within the old bankruptcy system were now squarely within the new system. While Congress fixed this one problem with the old concept of debt, it failed to notice that new families of obligations were developing or being created that would not fit easily within its new bankruptcy system.

10. Courts and commentators often get the definitional and the timing issues confused, or collapse them into one. See, e.g., cases cited *infra* note 81; JACKSON, LOGIC, *supra* note 3, at 34-35; DOUGLAS G. BAIRD & THOMAS H. JACKSON, CASES, PROBLEMS & MATERIALS ON BANKRUPTCY 132 (2d ed. 1990) [hereinafter BAIRD & JACKSON, CASES]; Douglas G. Baird & Thomas H. Jackson, *Comment: Kovacs and Toxic Waste in Bankruptcy*, 36 STAN. L. REV. 1199, 1204 (1984) (arguing that Congress was attempting to distinguish obligations based on past events from those based on future events in its definition of "claim"). However, the timing element is not part of the claim definition. An obligation that comes into being solely in the future can be a "claim," but it may not be recognized in bankruptcy because it "arose" either after the petition was filed or after the reorganization plan was confirmed.

For example, Ann drives through a red light and injures Bob the day *after* Ann files a Chapter 7 proceeding. Bob has a "claim" (because he has a right to payment), but the claim is not dealt with in the bankruptcy proceeding. Bob is not a "creditor" under 11 U.S.C. § 101(10), and the claim cannot be "allowed" under 11 U.S.C. § 502. The definition is independent of time. See Kathryn R. Heidt, *Environmental Obligations in Bankruptcy: A Fundamental Framework*, 44 FLA. L. REV. 153, 174-77 (1992).

11. 11 U.S.C. § 1126(a) (1988). Shareholders also participate in the process, but I am concerned here with those who are owed obligations by the company, not those who have an equity interest in it—although the dividing line is often far from clear.

12. See, e.g., 11 U.S.C. §§ 1122, 1123(a)(1), (3) (1988) (regarding classification and treatment of classes of claims); 11 U.S.C. § 1129(a)(7) (1988) (regarding minimum treatment for a holder of a claim); 11 U.S.C. § 1129(b) (1988) (regarding certain other rights of classes of claims).

13. 11 U.S.C. § 726(a)(1)-(4) (1988).

be discharged. Specifically, the Bankruptcy Code discharges a “debt,”¹⁴ which is defined as a “liability on a claim.”¹⁵

The Bankruptcy Code’s definition of “claim” is limited. “Claim” means a “right to payment,” and includes rights that are still contingent, unliquidated, or disputed. “Claim” also means a “right to an equitable remedy for breach of performance if such breach gives rise to a right to payment,” and includes remedies that are still contingent or disputed.¹⁶ Thus, the definition includes rights that are specifically legal in nature—i.e., those that are for money damages. It also includes equitable remedies, *if* the breach of the obligation that gave rise to the remedy also gives rise to a right to payment. Accordingly, if money can be substituted for the performance of the equitable obligation, the obligation will be subject to the bankruptcy process and may be discharged. The current definition does not include the purely equitable obligation¹⁷—i.e., an obligation for which money cannot be substituted—although I argue later that it should.

B. *Timing Requirements*

Second, the Code requires that a claim must “arise” before a specified time in order to be included within the bankruptcy process and in order to be discharged. Only those with claims that arose prior to the bankruptcy proceeding may share in a Chapter 7 distribution or vote on a Chapter 11 plan of reorganization.¹⁸ In Chapter 7, debts that arose prepetition are

14. 11 U.S.C. §§ 727(b), 1141(d)(1)(A), 1228(a), 1328(a) (1988).

15. 11 U.S.C. § 101(12) (1988).

16. The Bankruptcy Code provides:
“claim” means—

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

17. 11 U.S.C. § 101(5) (1988).

18. Congress specifically intended to exclude purely equitable obligations. Heidt, *supra* note 10, at 168.

19. Two paths of analysis lead to this conclusion. First, only a “creditor” may file a “proof of claim,” which may then be “allowed” by the bankruptcy court. 11 U.S.C. § 501(a) (1988). A “creditor” is an “entity that has a claim against the debtor that arose at the time of or before the order for relief . . .” 11 U.S.C. § 101(10)(A) (1988). The “order for relief” in a case in which the debtor has voluntarily filed a bankruptcy petition occurs at the time the petition is filed. 11 U.S.C. § 301 (1988). Thus, a “creditor” is one who holds a “claim” that arose at or before the time the bankruptcy petition was filed in a voluntary case. The creditor must file a proof of claim (unless it is properly

discharged,¹⁹ and in Chapter 11, debts that arose preconfirmation are discharged.²⁰

This timing scheme separates the past from the future. In the case of a corporate reorganization, it is necessary to discharge all of the past obligations in a single sweep to assure the future vitality of the reorganized corporation. In the case of the individual debtor, this scheme ensures that the debtor can make a fresh start, free from prior obligations. To give force to the bankruptcy discharge, the Bankruptcy Code enjoins creditors from enforcing their old (discharged) claims against the debtor.²¹ This injunction is necessary to bind all parties to the process. Without such an injunction, the individual's opportunity for a fresh start, and the corporation's ability to reorganize bound only by the terms of the plan of reorganization,²² would be jeopardized by the collective action problem—the race to seize and liquidate the debtor's assets resulting from first-come, first-served state law debt collection remedies.²³ While this timing scheme is effective for traditional debts, it is difficult to apply in the products liability, mass tort, and environmental context.

III. WHY NEW FORMS OF OBLIGATIONS ARE DIFFERENT: EXTRAORDINARY LIABILITY

Three factors differentiate the recent forms of liability, especially mass tort and environmental liability, from traditional debt. First, the magnitude of the harm from a single problem, defect, or act can be staggering. A single defective product (e.g., the Dalkon Shield or an airplane component), the massive use of a single product not known to be harmful (e.g., asbestos

listed on the debtor's schedules and statements) in order to have an "allowed claim," which in turn determines the share the creditor will receive on distribution and also the value of the creditor's vote in a Chapter 11 case. Second, not only the existence of a claim, but also the amount of a claim is determined or "allowed" as of the date of the filing of the petition. 11 U.S.C. § 502(b) (1988). Under the Code, only those with "allowed claims" share in a Chapter 7 distribution or can vote on a Chapter 11 plan.

19. 11 U.S.C. § 727(b) (1988). Only individuals receive a discharge in Chapter 7. 11 U.S.C. § 727(a)(1) (1988). However, questions of definition and timing are still important in a corporate liquidation because they determine who will share in the distribution.

20. 11 U.S.C. § 1141(d)(1) (1988).

21. 11 U.S.C. § 524(a)(2) (1988).

22. In a Chapter 11 case, the debtor and all creditors are bound by the terms of the plan of reorganization. Section 1141(a) of the Code substitutes the new plan obligations for the debtor's preexisting obligations. 11 U.S.C. § 1141(a) (1988).

23. See BAIRD & JACKSON, CASES, *supra* note 10, at 3-25 (providing an overview of state law collection methods).

or lead), or a single wrongdoing (e.g., the discharge of oil or toxic waste) can cause great harm to many people and to much property.²⁴

Second, these obligations have a “long tail”—that is, the negative effects of the product or substance may not be fully felt for a very long time. For example, a person exposed to asbestos might not suffer any noticeable injury for forty years.²⁵ Obligations caused by these substances will continue to arise well into the future.²⁶ Third, for at least some of these obligations, the debtor simply could not have known of its potential future liability at the time it committed the acts that ultimately gave rise to the obligations.²⁷

For the above reasons, I refer to these sorts of obligations as “extraordinary” harms or obligations.²⁸ These extraordinary obligations raise questions that were not fully contemplated when the Bankruptcy Code went into effect in 1979. Consequently, the Code is ill-equipped to handle such obligations.

24. For just a few tales of the toxic threat, see MICHAEL H. BROWN, *THE TOXIC CLOUD* (1987); MICHAEL H. BROWN, *LAYING WASTE* (1979); MARC LAPPE, *CHEMICAL DECEPTION: THE TOXIC THREAT TO HEALTH AND THE ENVIRONMENT* (1991); MICHAEL R. REICH, *TOXIC POLITICS, RESPONDING TO CHEMICAL DISASTERS* (1991); FRED SETTERBERG & LONNY SHAVELSON, *TOXIC NATION: THE FIGHT TO SAVE OUR COMMUNITIES FROM CHEMICAL CONTAMINATION* (1993).

25. For a summary of the facts in the asbestos cases, see Christopher F. Edley, Jr. & Paul C. Weiler, *Asbestos: A Multi-Billion-Dollar Crisis*, 30 HARV. J. ON LEGIS. 383, 387-89 (1993), as well as LAURENCE H. KALLEN, *CORPORATE WELFARE: THE MEGABANKRUPTCIES OF THE 80S AND 90S* (1991).

26. This factor has been recognized by others examining mass tort and environmental liability in nonbankruptcy contexts. See, e.g., Michael D. Green, *Successors and CERCLA: An Imperfect Analogy to Products Liability and an Alternative Proposal*, 87 NW. U. L. REV. 897 (1993).

27. On the other hand, sometimes risks were known or suspected, but warnings were ignored or product safety was not investigated sufficiently—i.e., the company intentionally turned a blind eye to information that would have exposed the risks. In the Johns-Manville case, the dangers of asbestos were known at the latest by the mid-1940s and possibly many decades earlier. See KALLEN, *supra* note 25, at 225-47. The danger of the Dalkon Shield was ignored by A.H. Robins despite several prominent warnings. See *id.* at 323-47; RICHARD B. SOBOL, *BENDING THE LAW: THE STORY OF THE DALKON SHIELD BANKRUPTCY* 1-22 (1991).

28. Environmental liabilities are extraordinary for another reason that has nothing to do with bankruptcy. Some believe that environmental matters affect world political stability. A group of scientific researchers has recently argued that environmental problems, especially those leading to scarce resources, are contributing to violent conflicts in parts of the world and have the potential to contribute to conflict and social instability in the future in poorer nations. Thomas F. Homer-Dixon et al., *Environmental Change and Violent Conflict*, SCI. AM., Feb. 1993, at 38; see also NORMAN MYERS, *ULTIMATE SECURITY: THE ENVIRONMENTAL BASIS OF POLITICAL STABILITY* (1993).

IV. FITTING EXTRAORDINARY LIABILITY INTO THE TRADITIONAL MODEL

A. *Mass Torts*

The mass tort cases presented the first major challenge to the courts in dealing with the new forms of liability within the traditional model.²⁹ In the asbestos bankruptcies, each case had a group of potential claimants—whom the courts called “future claimants.” These were claimants who had been exposed to asbestos in the past but who had not yet exhibited any symptoms or illness resulting from the exposure. In some instances the potential claimant might never become ill. In other instances the illness could take as long as forty years to manifest itself.³⁰ Although the debtors were able to predict the percentage of persons who would eventually contract asbestos-related illnesses, there was no way to identify who would actually be a future claimant.

The early cases excluded the future claimants from the bankruptcy process by holding that they did not have “claims” as defined by the Bankruptcy Code.³¹ These courts seemed to have been driven by a desire to be fair to the future claimants. They thought they were giving the future claimants the opportunity to pursue the company later when their claims arose. The courts were also driven by a sense that the bankruptcy filing was somehow inappropriate, or perhaps even abusive.³²

29. The discussion of the mass tort cases and the problems they present is brief. For additional discussions of problems that arise in the mass tort context, see Mark J. Roe, *Bankruptcy and Mass Tort*, 84 COLUM. L. REV. 846 (1984); Margaret I. Lyle, Note, *Claims and the Corporate Tortfeasor: Bankruptcy Reorganization and Legislative Compensation Versus the Common-Law Tort System*, 61 TEX. L. REV. 1297 (1983); Harvey J. Kesner, *Future Asbestos Related Litigants as Holders of Statutory Claims Under Chapter 11 of the Bankruptcy Code and Their Place in the Johns-Manville Reorganization* (pts. 1 & 2), 62 AM. BANKR. L.J. 69, 159 (1988); JACKSON, LOGIC, *supra* note 3; and Anne Hardiman, Recent Development, *Toxic Torts and Chapter 11 Reorganization: The Problem of Future Claims*, 38 VAND. L. REV. 1369 (1985).

30. See, e.g., *Kane v. Johns-Manville Corp.*, 843 F.2d 636, 639 (2d Cir. 1988).

31. *In re Amatek Corp.*, 30 B.R. 309, 315 (Bankr. E.D. Pa. 1983), *rev'd*, 755 F.2d 1034 (3d Cir. 1985); *In re UNR Indus., Inc.*, 29 B.R. 741, 745-46 (Bankr. N.D. Ill. 1983), *appeal dismissed*, 725 F.2d 1111 (7th Cir. 1984).

32. However, these cases were either reversed on appeal or modified after further proceedings. See *In re Amatek Corp.*, 755 F.2d 1034 (3d Cir. 1985), *rev'g* 30 B.R. 309 (Bankr. E.D. Pa. 1983). In *UNR* the Court of Appeals for the Seventh Circuit dismissed the appeal for lack of a final order, but the appellate court noted that in its view the rights of future claimants should be taken into account and inferred that it would appoint a representative for them. *In re UNR Indus., Inc.*, 725 F.2d 1111, 1119-20 (7th Cir. 1984). On remand, the bankruptcy court followed the trend developed by other courts and

Later courts recognized that the future claimants must be brought into the bankruptcy process primarily for two reasons: (1) to assure fair treatment for the future claimants, and (2) to assure an effective reorganization. First, if the future claimants were not taken into account, there might be nothing left after the bankruptcy proceeding for these claimants to recover.³³ Claimants who discovered their injuries and brought suit would be paid until the funds ran out. Later claimants would receive nothing. Second, if the claims of these future victims were not brought into the process, the company would be forced to file successive bankruptcy petitions and continually reorganize each time the liability from the mass tort cases brought against it rose to a level that again challenged the corporation's vitality.³⁴

Though the courts recognized that they must bring these obligations into the bankruptcy proceeding, they faced several problems. Initially, the obligations did not fit neatly into the definition of "claim." Specifically, courts questioned whether a person who had been exposed to harmful substances but not yet developed symptoms had a "right to payment." Some courts reasoned that if the victim had no symptoms then the victim had no right under state law to pursue the debtor and, thus, no claim within the meaning of the Bankruptcy Code. Secondly, some courts also questioned whether the claim had "arisen" within the proper time period for inclusion in the bankruptcy process.³⁵

Eventually, courts started to sidestep these technical questions and to bring the future claimants into the process by holding that the future claimants were entitled to be heard and, therefore, to be represented. Specifically, the courts deemed these claimants "parties in interest" under

appointed a legal representative for the later claimants. *In re UNR Indus., Inc.*, 46 B.R. 671 (Bankr. N.D. Ill. 1985).

33. Courts recognizing this problem include: *In re Amatech*, 755 F.2d at 1042 ("[F]ailure to provide for future claimants in a reorganization plan might fatally undermine any such plan as well as prejudice the position of future claimants."); *In re Johns-Manville, Inc.*, 36 B.R. 727, 746 (Bankr. S.D.N.Y. 1984). In *In re Forty-Eight Insulations, Inc.*, the debtor was liquidating in Chapter 11. Thus, if the future claimants were not taken into account in the proceeding, they would never have any recovery. *In re Forty-Eight Insulations, Inc.*, 58 B.R. 476, 477 (Bankr. N.D. Ill. 1986).

34. *In re Amatech*, 755 F.2d at 1043; *In re Johns-Manville*, 36 B.R. at 746.

35. In *In re UNR Indus., Inc.*, the lower court looked at both the timing and the definitional issue in deciding that the future victims did not have claims. The court said first that to be cognizable in bankruptcy the claim must be one that is recognized by state or federal law. The court then said that the existence of the claim depends on when it arose. A tort claim arises when the victim suffers an injury. Since no injury had been suffered, there was no claim. 29 B.R. 741, 745 (Bankr. N.D. Ill. 1983).

§ 1109 of the Code.³⁶ The courts also called upon their general equitable powers to support their decisions to bring these obligations into the bankruptcy proceeding.³⁷

However, simply calling future victims "parties in interest" and appointing a representative to protect their interests in bankruptcy did not prove to be a complete solution. Courts had to find a way to satisfy the claims that would eventually arise, and they had to find a way to bind the future claimants to the process. In most mass tort cases, a trust fund was set up to pay future claimants. In some cases the trust was funded from the sale of the debtor as a going concern,³⁸ and in others it was funded with stock, future profits, and insurance proceeds.³⁹

Including future claimants in the process would be ineffective if claimants were not bound by the process. Since the courts had refused to hold that the future claimants had "claims," those future obligations would not be discharged in the bankruptcy. If these future claims were not discharged, the future claimants would not be prohibited from suing the reorganized debtor later for the obligation,⁴⁰ a result that would make the reorganization futile. To address this problem, the *Johns-Manville* court approved, over objection, an injunction contained in the plan of reorganization that prohibited future claimants from suing the reorganized debtor.⁴¹ In effect, the future claimants "[were] treated identically to the present claimants by virtue of the Injunction."⁴² Thus, the future claimants had to look to the reorganization plan for their recovery. These so-called

36. *In re Amatex*, 755 F.2d at 1042; *In re Forty-Eight Installations*, 58 B.R. at 478; *In re Johns-Manville*, 36 B.R. at 759.

37. *In re UNR Indus.*, 725 F.2d at 1119, (explaining that the bankruptcy court had the power to appoint a representative for the future claimants); *In re Forty-Eight Installations*, 58 B.R. at 477. Section 105 gives the bankruptcy courts general powers of equity. 11 U.S.C. § 105 (1988). It is unclear, however, how far those powers extend, especially if the result would conflict with an express provision of the Bankruptcy Code or other applicable law. See generally Adam J. Wiensch, Note, *The Supreme Court, Textualism, and the Treatment of Pre-Bankruptcy Code Law*, 79 GEO. L.J. 1831, 1859-62 (1991).

38. This type of funding was used in the A.H. Robins bankruptcy proceeding for the Dalkon Shield claimants. Kenneth R. Feinberg, *The Dalkon Shield Claimants Trust*, LAW & CONTEMP. PROBS., Aug. 1990, at 79.

39. See generally *Roe*, *supra* note 29. This type of funding was used in the Johns-Manville bankruptcy.

40. Section 524(a)(2) prevents a claimant from pursuing the debtor for a discharged debt. 11 U.S.C. § 524(a)(2) (1988).

41. *In re Johns-Manville Corp.*, 68 B.R. 618, 622 (Bankr. S.D.N.Y. 1986).

42. *Kane v. Johns-Manville Corp.*, 843 F.2d 636, 640 (2d Cir. 1988).

“channeling orders” have thus far been upheld by the courts.⁴³

In the mass tort cases, the courts had to perform some impressive gymnastics to reach a result that they thought was best for all concerned—a reorganization that maximized recovery for existing and future claimants. These courts, for the most part, reached results consistent with each other and consistent with bankruptcy policy, as will be discussed later. Other products liability cases and the environmental cases have not reached such consistent results.

B. Other Products Liability Cases

Other products liability cases have also challenged the courts.⁴⁴ The bankruptcy of Piper Aircraft Corporation illustrates the problems that may arise in this context. In *In re Piper Aircraft Corp.*,⁴⁵ the court held that victims who would be injured in the future, due to a defect in an aircraft built by the debtor in the past, did not have claims that could be recognized in the bankruptcy proceeding. While the court discussed the issue largely in terms of the definition of “claim,” it also infused timing concerns into the definitional issue. Therefore, *Piper* is more properly discussed as a timing case.

In *Piper* the debtor had manufactured aircraft for many years. At the time of the bankruptcy filing, 50,000-60,000 aircraft were still in use in the United States. Although the debtor had never acknowledged any defects in the design or manufacture of its aircraft, it had been involved in a number of products liability lawsuits. The drain of defending and settling these suits contributed to the debtor’s decision to file a Chapter 11 petition. Accidents involving the aircraft still in use were virtually certain to occur

43. While the result sounds like a good one in theory, the *Johns-Manville* case has encountered many problems. The available funds have not been able to keep pace with the claims that have been presented. The trust has been modified as a result, and its future effectiveness is uncertain. Those problems were largely due to nonbankruptcy factors, however: the number of potential future claimants was severely underestimated, publicity of the case caused more claims to be filed early on than the statistics predicted, and the plaintiff’s lawyers did not know how to deal with the bankruptcy process, which resulted in a lengthy period of infighting. As one plaintiff’s lawyer is reported to have said, “There is a steep learning curve in the mass tort/bankruptcy cases, and Johns-Manville was it.” See generally Steven Labaton, *Asbestos Trust Fund of Manville Queried*, N.Y. TIMES, May 16, 1990, at D1; Stephen Labaton, *Manville Trust Fund May be Forced into Stock Sale*, WALL ST. J., Feb. 8, 1989, at A6.

44. In addition to the cases discussed in this section, see *Lemelle v. Universal Mfg. Corp.*, 18 F.3d 1268 (5th Cir. 1994), and *In re Pettibone Corp.*, 90 B.R. 918 (Bankr. N.D. Ill. 1988).

45. *In re Piper Aircraft Corp.*, 162 B.R. 619 (Bankr. S.D. Fla. 1994), *aff’d*, 168 B.R. 134 (S.D. Fla. 1994).

in the future. As in the mass tort cases, a legal representative was appointed to represent the future claimants, who filed a claim in the amount of \$100,000,000 based on statistical assumptions regarding the debtor's design, manufacture, sale, and distribution of aircraft and parts.⁴⁶

The court held that absent some prepetition relationship between the debtor and the future claimants, coupled with prepetition conduct that could give rise to an injury, the future claimants failed "even the broadest test for the recognition of a 'claim.'"⁴⁷ The court said that successor liability principles controlled whether the future claimant (the person injured in the future by a past act of the debtor) could recover, and noted that these principles might vary from state to state.⁴⁸ The court further noted that holding that the future claimants had claims would present both practical problems and significant problems of due process.⁴⁹

The court's ruling in *Piper* is wrong for several reasons. The court's key error was to treat similar creditors unequally. Under this decision, victims injured by the very same act (e.g., the manufacture of a defective part) will be treated differently. All of the claimants, both past and future, were injured by preconfirmation acts. Those who are fortunate enough⁵⁰ to be injured after the bankruptcy confirmation may be compensated in full while those who were injured prior to the bankruptcy will be paid in bankruptcy dollars. Though the court is generally correct when it says that "timing matters" in bankruptcy,⁵¹ timing should not matter here. Only the timing of the commission of a new harmful act matters, not the mere occurrence of an injury that results from prepetition (or preconfirmation) negligence.

46. *Id.* at 621-22. The legal representative had requested the court to estimate the claim for voting purposes. The creditors' committee and the debtor objected to the claim. The court addressed the issue of whether these future claimants had "claims" within the meaning of § 101(5). *Id.*

47. *Id.* at 627-28. The court rejected various tests adopted by the courts *In re M. Frenville Co.*, 744 F.2d 332 (3d Cir. 1984), *cert. denied*, 469 U.S. 1160 (1985); *Grady v. A.H. Robins Co.*, 839 F.2d 198 (4th Cir. 1988), *cert. dismissed*, 427 U.S. 1260 (1988); *In re Waterman S.S. Corp.*, 141 B.R. 552 (Bankr. S.D.N.Y. 1992), *vacated on other grounds*, 157 B.R. 220 (S.D.N.Y. 1993); *In re Pettibone*, 90 B.R. 918 (Bankr. N.D. Ill. 1988); and *In re Chateaugay Corp.*, 944 F.2d 997 (2d Cir. 1991).

The *Piper* court rejected the argument that its holding would cause disparate treatment of victims solely because of the happenstance of when a crash occurs. The court said that "In bankruptcy, as in life, timing matters." *Piper*, 162 B.R. at 628. The court found that it was perfectly acceptable that a person harmed after confirmation by an aircraft built by the debtor would have a postreorganization claim that was not recognizable in the bankruptcy proceeding. *Id.*

48. *Id.*

49. *Id.* at 628.

50. They are fortunate only if the company reorganizes, is required to pay them in the future, and can pay them in the future.

51. *Piper*, 162 B.R. at 628.

In the *Piper* case, all of the harmful acts were done preconfirmation. While it is true that one group of claimants can be identified now (the preconfirmation claimants) and the other group cannot (the future claimants), this distinction should not matter for bankruptcy distribution purposes. By distinguishing between these claimant groups, *Piper* violates the fundamental policy of bankruptcy law that similar creditors are to be treated similarly. This error is perhaps most apparent when we stop to consider the result if the debtor were a liquidating corporation. Under the *Piper* decision, those who are injured in the future as a result of the debtor's past acts will not be able to recover. They cannot recover in bankruptcy because they did not have claims, and there will be no successor corporation from which they can recover in the future.

C. *Environmental Obligations*

Like the mass tort obligations, environmental obligations do not fit easily into the traditional debt model. It is difficult to determine which environmental obligations should be included in a bankruptcy proceeding.

Environmental obligations are different from most of the mass tort obligations that the bankruptcy courts have considered. The typical mass tort case, including the Dalkon Shield case and most of the asbestos cases, involved prepetition exposure to a dangerous item or hazardous substance. In most cases the source of danger had been removed.⁵² In the environmental cases, however, a contaminated site can cause postpetition injury arising from postpetition exposure. Not only does the continued presence of contamination create the possibility for additional future injury, but environmental contamination, if it is not corrected, can also spread and cause still greater injury.

Some commentators have said that the activities that give rise to CERCLA liability are largely "over."⁵³ I suggest that such statements are premature: extraordinary environmental threats are not a thing of the past. First, "report cards" for various industries, especially waste hauling, show that improper leakage and disposal continue to occur. Second, there are many contaminated sites of which no one is aware, and these sites will

52. Most victims who would ever suffer from an asbestos-related disease were exposed prepetition. Similarly, most women who would ever suffer an injury due to the Dalkon Shield had already been exposed to it. Nonetheless, the fact that some asbestos remains in buildings and has the potential to cause additional future harm makes the asbestos cases similar to the environmental cases. Yet most courts and writers overlook this possibility of future harm.

53. Green, *supra* note 26, at 922.

continue to worsen. Third, there is a growing trend to cut back on toxic waste cleanup, or at least to pause and ask whether it is worth the cost and effort to rid our environment of every last bit of toxic waste.⁵⁴ Finally, and perhaps most important, is the lesson we learn from a series of mass tort and environmental calamities: as our modern society continues to develop new products, it is likely that there will be an extraordinary harm, environmental or otherwise, that will replace toxic waste. Even now, scientific research suggests that the effects of lead paint may be worse than those of asbestos.⁵⁵

In environmental cases the courts have not sidestepped the critical questions as they did in the mass tort cases. Rather, they have shoehorned the various environmental obligations into (or out of) the traditional model. This attempt to fit these obligations into the existing model has created layers of confusion, both from a bankruptcy perspective and from an environmental perspective. One cannot predict with any certainty how a particular environmental obligation will be treated in bankruptcy. Even obligations that at first seem "easy," such as the obligation to pay money and the obligation not to pollute in the future, prove difficult to categorize.

There are three basic types of environmental obligations: (1) an obligation to pay money, e.g., to reimburse the government or another responsible party⁵⁶ for a past environmental cost, fine, or penalty; (2) an obligation to perform cleanup; and (3) an obligation to refrain from polluting in the future. However, the lines between these three categories are often blurred, which heightens the existing confusion.

To illustrate this lack of clarity, consider the example of a person responsible for pollution at a particular site. The polluter may have to pay investigatory and other costs to the government (category 1) and may have to clean up the pollution (category 2). But if the government chooses to clean up the site pursuant to the statute, the cleanup obligation moves from the second to the first category. Under CERCLA, however, an obligation to reimburse the government in the first category does not technically arise

54. See, e.g., STEPHEN G. BREYER, *BREAKING THE VICIOUS CIRCLE: TOWARD EFFECTIVE RISK REGULATION* (1993); DIXIE LEE RAY & LOU GUZZO, *ENVIRONMENTAL OVERKILL: WHATEVER HAPPENED TO COMMON SENSE?* (1993).

55. Dennis Hevesi, *Lead Paint Worse Than Asbestos*, *Report Says*, *NY TIMES*, Sept. 15, 1993, at B15.

56. Although not a defined term, "responsible party" is a term used to indicate a person who is liable under Superfund. See U.S. ENVTL. PROTECTION AGENCY, *A MANAGEMENT REVIEW OF THE SUPERFUND PROGRAM* app. III, at 3 (1989).

until the government has "incurred" costs.⁵⁷ Thus, if the government has not yet spent any money on the particular site, it can forbear doing so in order to exempt itself from the bankruptcy proceeding and to allow for the possibility of full future recovery. The government's decision whether to spend money or to wait would be made based on its predicted recovery inside and outside of the bankruptcy process.

The government has argued that when it has not yet incurred any costs, it does not yet have a right to recover against the debtor. Consequently, the government can argue that it should be outside the bankruptcy proceeding because it has no "claim," or alternatively, that the claim has not yet "arisen."⁵⁸ However, this argument should be rejected.⁵⁹ So long as all of the acts that give rise to the obligation have taken place, the obligation comes into existence. Just because CERCLA provides that the government may recover costs *incurred* does not mean that the obligation is not cognizable in bankruptcy before costs are actually incurred. The property is contaminated, and current law allows the government to investigate and respond to the problem. The fact that the government has not yet spent any money on cleanup is irrelevant.⁶⁰

The first category of obligation (to reimburse monetary expenditures) is the easiest to deal with in bankruptcy. It is a "right to payment" and is therefore a "claim." It has already been incurred, it "arose" prepetition, or preconfirmation in the case of Chapter 11, and it will be discharged. At the opposite extreme, the third obligation (to refrain from polluting in the future) is not a "claim" under the current definition. It is neither a right to

57. 42 U.S.C. § 9607(a)(4)(A)-(B) (1988).

58. Superfund imposes liability for "costs of removal or remedial action *incurred* . . ." 42 U.S.C. § 9607(a)(4)(A) (1988). The government has argued that if the obligation has not yet been incurred by the government, then the obligation has not arisen for bankruptcy purposes. Most courts have rejected this argument and held that the incurring of costs is not what triggers liability. See, e.g., *In re Chateaugay Corp.*, 944 F.2d 997 (2d Cir. 1991); *In re National Gypsum Co.*, 139 B.R. 397 (N.D. Tex. 1992); *In re Jensen*, 127 B.R. 27 (Bankr. 9th Cir. 1991), *aff'd*, 995 F.2d 925 (9th Cir. 1993). One court agreed with the government, but it may have been swayed by the government's lack of notice or knowledge sufficient to file a claim in the bankruptcy proceeding. *United States v. Union Scrap Iron & Metal Corp.*, 123 B.R. 831, 835 (D. Minn. 1990).

59. I am assuming that the debtor does not own or operate the property currently, in which case the debtor would be under a current obligation to clean up.

60. To simplify the discussion, I assume that the first category of environmental obligations have already been fully incurred. Other questions relating to when an obligation "arises" for purposes of classifying the obligation in bankruptcy are left to the discussion of the cleanup obligation. See *infra* notes 62-83 and accompanying text.

payment nor an equitable remedy for which money could now be substituted.⁶¹ Further, this obligation arises every day that the debtor continues to operate. Thus, it does not satisfy either the definitional or the timing requirements for discharge in the bankruptcy proceeding.⁶²

The most difficult environmental obligation to categorize and address in bankruptcy is the second obligation—the obligation to clean up contaminated property.

1. Is the Cleanup Obligation a "Claim"?

An order requiring the debtor to clean up a contaminated site presents a more difficult case for the courts. The order is not on its face a "right to payment." A cleanup order may take the form of an injunction, or be reduced to an injunction when the debtor fails to comply. Do these orders fit the second definition of a "claim": "a right to an equitable remedy for breach of performance if such breach gives rise to a right to payment . . . ?"⁶³ This subpart discusses the confusion caused by the current definition of "claim," which distinguishes between legal and purely equitable obligations.

Some, but not all, environmental statutes expressly provide enforcement alternatives: the government can order a person to clean up a site or the government itself can perform the cleanup and then seek reimbursement. Based on the Bankruptcy Code's definition of "claim," a cleanup order issued under a statute that has an alternative right to payment should be a claim, while one issued under a statute without such an alternative should not be a claim. The case decisions, however, do not follow the statutory language so faithfully.

CERCLA is an example of a statute with an alternative right to payment. The government can compel cleanup or it can perform the cleanup and then seek reimbursement.⁶⁴ Yet the Court of Appeals for the Second Circuit,

61. While the government might be willing to accept money after pollution has occurred in lieu of actually requiring remediation, the environmental laws dealing with toxic waste do not currently allow one to pay money in advance for the right to pollute.

62. The obligation can make or break a reorganization, however, and needs to be considered. See *infra* text accompanying notes 117-21.

63. 11 U.S.C. § 101(5)(B) (1988). I conclude that these obligations should be taken into account in the bankruptcy process, but to the extent that the reorganized debtor continues to own or operate the property, the debtor must clean up as required by current law. See *infra* text accompanying notes 107-16.

64. 42 U.S.C. §§ 9604(a)(1), 9606 (1988).

in *In re Chateaugay Corp.*,⁶⁵ refused to rule categorically that all CERCLA cleanup orders are "claims." Specifically, the Second Circuit held some such orders to be "claims," but stated that a cleanup order was not a claim to the extent the order requires the debtor to take "action that ends or ameliorates current pollution."⁶⁶ The court attempted to draw a distinction between sites that were currently causing additional pollution and those that were not, but the opinion is far from clear.

Several cases have involved statutes that did not have an express alternative right to payment. The United States Supreme Court, in *Ohio v. Kovacs*,⁶⁷ held that the State of Ohio had a "claim" because it had acted pursuant to other state laws that effectively gave the state control over the debtor's assets. The state environmental statute involved in *Kovacs* did not contain an alternative right to payment. The State of Ohio had ordered Mr. Kovacs to clean up a site contaminated by him and the corporation he owned and operated. When Kovacs failed to clean up, Ohio pursued a remedy under a general state statute allowing the court discretion to appoint a receiver to carry out a judgment.⁶⁸ After the appointed receiver took control of Kovacs' assets and dispossessed Kovacs, rendering him unable to carry out the cleanup himself, the Court held that the order had been effectively transformed into a right to payment.⁶⁹ The Court was careful to say that it was not deciding what the result would have been had the receiver not actually been appointed.⁷⁰

Although the Court limited its holding to the facts, the decision raises further questions. States have mechanisms for enforcing equitable judgments. These mechanisms may transfer control of the debtor's assets to the state. Will an attempt to enforce an equitable judgment transform the obligation into a "right to payment"? If so, remedies that are otherwise purely equitable might ultimately be deemed "claims" within the meaning of the Bankruptcy Code.⁷¹

65. 944 F.2d 997, 1105 (2d Cir. 1991).

66. *Id.*

67. 469 U.S. 274 (1985).

68. For a discussion of the specific enforcement statute involved, see Heidt, *supra* note 10, at 172-74.

69. 469 U.S. at 276-77.

70. *Id.* at 283-85.

71. In *Kovacs*, the right to pursue the debtor's assets rested within the discretion of the court. In that case, the state actually used the available state statutes to pursue the debtor's assets. It was only after the state's inchoate "rights" were "actualized" as a result of court action that the obligation achieved "claim" status. 469 U.S. at 710. Further, the state had sought discovery from the debtor regarding his income and the state had admitted that it would have been satisfied with money. *Id.* at

Subsequent cases are even more unusual. In *In re Whizco, Inc.*⁷² the government obtained an injunction ordering the individual debtor to reclaim property disrupted by surface mining. The applicable law did not have an alternative right to payment. The government, probably mindful of *Kovacs*, was careful not to pursue the debtor for money, oust the debtor from possession, or in any way attempt to enforce its injunction. Yet, the Sixth Circuit held that the cleanup obligation was a "claim" to the extent it that would require the debtor to spend money.

By contrast, in a case with virtually identical facts, the District Court for the Western District of Pennsylvania reached the opposite result. In *United States v. Hubler*⁷³ the court agreed with the government that its enforcement of a reclamation order was not a "claim" within the meaning of the Bankruptcy Code and was, therefore, not discharged. The Third Circuit reached a similar result in *Torwico Electronics, Inc. v. New Jersey Department of Environmental Protection*.⁷⁴ The *Torwico* court held that an injunction ordering the debtor to clean up a site that it had previously leased but no longer occupied was not a claim. This decision effectively gave the government, which could compel cleanup, priority over other creditors.⁷⁵

Later cases have focused on the relationship between the government and the debtor to determine whether a claim exists and, if so, when it arose. This adds still more layers to the problem. In *In re National Gypsum Co.*⁷⁶ the court held that future costs that were within the fair contemplation of the parties were claims under the Bankruptcy Code.⁷⁷ Still other cases turn on whether the government or other creditor had knowledge of the contaminated site or the bankruptcy. Although these cases usually address the question of whether the creditor has a "claim" that "arose" preconfirmation, they have additional overtones. Specifically, due process

709. If we read *Kovacs* as limited to these facts, the mere existence of a mechanism under the general laws of the state to enforce an equitable remedy should not be sufficient to transform the obligation into a claim. Rather, the state must actually pursue that alternative, and the court must grant the remedy. Inchoate "rights" must become "actualized" before "claim" status attaches. This conclusion is consistent with the intent of Congress to exclude purely equitable remedies from the definition of "claim." H.R. REP. NO. 595, 95th Cong., 1st Sess. 309 (1977); S. REP. NO. 989, 95th Cong., 2d Sess. 21 (1988).

72. 841 F.2d 147 (6th Cir. 1988).

73. 117 B.R. 160 (W.D. Pa. 1990), *aff'd*, 928 F.2d 1131 (3d Cir. 1991).

74. 8 F.3d 146 (3d Cir. 1993), *cert. denied*, 114 S. Ct. 1576 (1994).

75. The decision violates two bankruptcy policies discussed later: (1) the policy of the fresh start or debtor rehabilitation, and (2) the policy of treating similar creditors similarly. See *infra* subpart IV.A.

76. 139 B.R. 397 (N.D. Tex. 1992).

77. *Id.* at 409.

drives a concern that creditors have adequate notice or knowledge of the obligation.⁷⁸

These cases interpreting the definition of "claim" cannot be reconciled on any level. Some courts reviewing facts that seem to be squarely within the definition of "claim" hold that the obligation is not necessarily a "claim."⁷⁹ According to other courts, it is the attempt to enforce a judgment that transforms the obligation into a "claim." Still other courts look at factors such as the relationship between the parties, or who knew what when. Even the cases that involved individual debtors who owed equitable obligations do not reach consistent results.⁸⁰ The situation is made still more confusing and more difficult to analyze because many cases do not distinguish between the definitional question (Is it a "claim"?) and the timing question (When did the claim "arise"?).⁸¹

2. When Does the Obligation "Arise"?

Perhaps more difficult than the definitional question is the question of timing: When did the obligation "arise"? The first and third obligations are again easier than the second obligation. To the extent the government actually incurred costs in the past with respect to a particular site, the obligation can be said to "arise" in the past. As noted earlier, the government may argue that it does not yet have a right to recover under CERCLA if it has not yet "incurred" costs. However, the better view is to

78. *United States v. Union Scrap Iron & Metal*, 123 B.R. 831 (D. Minn. 1990); *Sylvester Bros. Dev. Co. v. Burlington N. R.R.*, 133 B.R. 648 (D. Minn. 1991).

79. See discussion of *In re Chateaugay* *supra* text accompanying notes 65-66.

80. *Kovacs, Whizco*, and *Hubler* all involved individual debtors who owed an equitable obligation. The obligation to perform reclamation work or cleanup can obviously be quite large and, unless discharged, can eliminate any "fresh start" the debtor might otherwise receive. Courts that have considered cleanup obligations in bankruptcy cases involving individual debtors have not explicitly mentioned this factor, but one cannot help wondering whether they took it into account, whatever the result they reached. The court in *Hubler* did not discharge the obligation. 117 B.R. at 165. The court in *Kovacs* discharged the obligation. 469 U.S. at 285.

The court in *Whizco* effectively discharged the obligation when it granted a discharge to the extent that the obligation would require the debtor to spend money to comply. 841 F.2d at 151. In *Whizco* the court said that it was not discharging the obligation to the extent the debtor might in the future own or possess equipment that he could use to reclaim the property. *Id.* at 150-51. Thus, if the debtor ever acquired a bulldozer, the court implied that he would be required to use it to clean up the site. This holding may dissuade the debtor from ever again engaging in the mining business, perhaps the only business he knew. Though the court did not specifically address the rehabilitation issue, this holding clearly limits a debtor's fresh start.

81. See, e.g., *In re Chateaugay*, 944 F.2d 997 (2d Cir. 1991); *In re National Gypsum*, 139 B.R. 397 (N.D. Tex. 1992); *United States v. Union Scrap Iron & Metal*, 123 B.R. 831 (D. Minn. 1990).

treat the claim as arising when the contamination took place.⁸²

At the other extreme is the obligation to comply on an ongoing basis with the environmental laws. If the debtor continues in business, it has an obligation that “arises” every day to comply with the current environmental laws. It must dispose of its wastes correctly, just as it must pay minimum wage, pay taxes, and meet other regulatory standards.

The cleanup obligation falls somewhere in the middle. It is like a traditional obligation because the acts giving rise to the obligation took place in the past.⁸³ However, the contaminated property may cause additional harm in the future. The potential for harm can, in fact, grow much greater as the contamination expands. Therefore, it is impossible to separate the cleanup obligation into a past and a present component. CERCLA requires the current owner to clean up the site. If the debtor continues to own the contaminated property, the debtor would be required to clean it up. This obligation would arise every day so long as the debtor owns or operates the property.

However, if the debtor is only liable as a former owner or as an arranger or transporter, and does not currently own or operate the property, there is no continuing obligation to clean up the contamination. In this case, the obligation arguably arose only in the past. But due to the possibility of future harm, even this obligation cannot be separated easily into a past and a present component.

D. Problems Resulting from Applying the Existing Paradigm

The current treatment of environmental obligations in bankruptcy leads to many nonsensical results—beyond merely which obligations are subject to the proceeding and which are not. Similar environmental obligations can receive widely varying treatment. For example, one debtor may be allowed to “abandon” its contaminated site, while another debtor cannot.⁸⁴ Abandonment allows the debtor to rid itself of the property and the current, ongoing obligation to clean up. Another example is that priority payment

82. See *supra* text accompanying notes 58-60. If the debtor continues to own or operate the property, the cleanup obligation will arise every day.

83. Thus, some have argued that the cleanup obligation should be deemed to arise in the past. See JACKSON, LOGIC, *supra* note 3, at 55; Baird, *A World Without Bankruptcy*, *supra* note 3, at 180.

84. Despite the Supreme Court's ruling in *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Resources*, 474 U.S. 494 (1986), many courts have allowed abandonment under 11 U.S.C. § 554(a) if abandonment will not pose an immediate threat to the public. See, e.g., *In re Smith-Douglas, Inc.*, 856 F.2d 12 (4th Cir. 1988); *In re Ferrante & Sons, Inc.*, 119 B.R. 45 (Bankr. D.N.J. 1990); *In re Doyle Lumber, Inc.*, 137 B.R. 197 (Bankr. W.D. Va. 1992).

for a government-funded cleanup can depend on whether the cleanup occurs before or after bankruptcy. If the government cleans up contaminated property owned by the debtor before bankruptcy, the reimbursement obligation is an ordinary unsecured obligation. If the government cleans up property owned by the bankruptcy estate, the government has an administrative expense—a first-priority claim.⁸⁵ While the rules make technical sense, the results are insupportable. These inconsistent results are due to the lack of a comprehensive theory or framework for choosing which extraordinary obligations to include and which to exclude from the bankruptcy process.

Due to the uncertainty regarding the treatment of environmental obligations in bankruptcy, a notable and disconcerting phenomenon is taking place: decisions regarding the necessity of and the responsibility for cleaning up environmental contamination are being made by nondecisionmakers. Because these new obligations do not fit within the existing paradigm, the parties increasingly resort to litigation to resolve the status of the claims. And because lawyers and parties are unsure of how their claims might be classified by the courts, the parties respond to this uncertainty by negotiating their own resolution. Thus, rather than Congress or the courts, it is the litigants themselves who are making remediation decisions that have serious consequences for the public health and welfare.

For example, in the LTV bankruptcy case, the EPA decided not to require the reorganized debtor to clean up contaminated property that it continues to own and operate. All parties agreed that the cleanup obligation would not be discharged by the bankruptcy, but the EPA also agreed that it would not pursue the debtor for cleanup in the near future. The parties took a wait-and-see approach. Although CERCLA requires the current owner to clean up the property, the EPA apparently does not want to be seen as the final cause of a debtor's failure that results in the loss of thousands of jobs. In effect, the EPA made the decision to forgo immediate cleanup in order to preserve these jobs.

The EPA, despite an explicit Congressional mandate to the contrary, appears to be making the policy decision that preserving jobs and a tax base is more important than remediating contamination. While we might excuse the EPA if it had been acting in its administrative capacity as a

85. If the debtor continues to own or operate the property, the cleanup has benefitted the estate. Thus, it arguably qualifies as an administrative expense under § 503(1)(B). 11 U.S.C. § 503(1)(B) (1988). Courts have generally agreed. *See, e.g., In re Wall Tube & Metal Prod. Co.*, 831 F.2d 118 (6th Cir. 1987).

decisionmaker, the EPA was not so acting, and neither was it acting in accordance with the rules that prescribe and proscribe its decisionmaking authority. The EPA is charged with protecting the environment, not protecting jobs. It is not the appropriate decisionmaker in this context.

Similarly, through negotiation and compromise in a bankruptcy proceeding, other environmental decisions may be made by trustees, managers, creditors, and attorneys. While we have long tolerated the fact that bankruptcy negotiations affect third parties—employees, local citizens, etc.—the extent of that effect is usually limited. In the mass tort, products liability, and environmental context, however, the effects can have a much broader range. These decisions bear directly on the crucial distributional question of how to allocate the effects of the debtor's widespread default. The EPA is not the appropriate body to make choices about those allocations. In order to prevent such inappropriate decisionmaking by litigants, we must remove the uncertainty surrounding the determination of which obligations will be included in the bankruptcy process.

E. Summary

We have seen extraordinary obligations appear and grow to record levels in a very short time. These obligations, especially environmental cleanup obligations, simply do not fit the paradigm of debt on which the bankruptcy system is based. Courts have done what problem solvers have always tried to do in the face of an outmoded paradigm—they have tried to force the problem into the model. By constantly forcing these obligations into the existing model, however, the courts have only created uncertainty. Uncertainty leads to litigation in which the litigants end up resolving or deciding the issue. Decisions that affect large segments of the public are being made by the parties to a reorganization.

The traditional paradigm no longer works well. It is time for a new one. The only question is: What should it be?

V. A SOLUTION

A. Summary of the Solution

A complete solution to the problem has two parts. The first part addresses the problem of extraordinary liabilities outside of bankruptcy and the second considers the problem inside of bankruptcy. The first considers possible solutions in the area of tort law, corporate law, lender liability, and various other areas of advancing law. In a perfect world, these solutions

would make corrective tort or environmental obligations a thing of the past—we would make sure that all tort and environmental obligations were fully met and that all related costs were fully internalized and paid immediately.

The second part recognizes that we will still have to deal with situations in which significant tort or environmental obligations or other extraordinary liabilities exist. Not every company will succeed in properly internalizing its costs and paying them on a current basis. Even with good intentions, some costs or obligations may still arise due to accidents, and the environmental laws impose strict liability, even for accidental harm. Further, even if it were possible to internalize costs fully and immediately, it would take many years for a system of internalization to be fully implemented, and we will have to address the question of how to deal with these obligations in bankruptcy for some time to come.

One's opinion on how extraordinary liabilities should be treated in bankruptcy depends largely on one's view of the functions and goals of bankruptcy law. In this section, I look at these liabilities from different perspectives of bankruptcy policy. Because a primary function of bankruptcy law is to distribute the effects of failing businesses, I ultimately decide that (1) obligations that will arise based solely on the past acts of the debtor should be subject to the bankruptcy system (i.e., distribution will be made to the holders of those claims when they arise, even if postbankruptcy, but those claims will be discharged in the bankruptcy), but (2) new postbankruptcy obligations are not discharged even if a prebankruptcy act gave rise to the obligation. That is, acts done in the past that continue to give rise to postbankruptcy liability of the reorganized company must be satisfied.

The result of this solution is that the future victims of the debtor's past negligent manufacture of products will be brought into the bankruptcy process. They will have a say in that process and their claims will be discharged. However, the debtor who owns or operates contaminated property and continues to own or operate the property after bankruptcy will find that the associated cleanup obligation is both a past and a current obligation. Because the debtor had the obligation to clean up prebankruptcy, the government (or other environmental creditor) will have a prepetition claim, and thus, will have a say in the process through the Chapter 11 scheme. The prepetition (preconfirmation) obligation will be discharged. However, since current law requires the owner or operator of the contaminated property to clean up, the government will also have a new postbankruptcy obligation that it can enforce. This obligation is not discharged in bankruptcy.

B. Part 1: Proper Internalization of Extraordinary Obligations

The optimal solution to the problem of torts and environmental obligations in bankruptcy is to eliminate them. We can eliminate some of these costs by properly internalizing them.⁸⁶ A full examination of the ways in which these obligations can be internalized is beyond the scope of this paper, but I will mention a few possible methods of internalization.

First, extraordinary obligations could be treated like corporate tax obligations. State and federal laws could adopt a system of corporate officer liability similar to the one imposed by the Internal Revenue Code. Specified officers would face potential liability for environmental harms, mass torts, and other extraordinary liabilities.⁸⁷ In the environmental context, this liability can be added to CERCLA and the other relevant environmental statutes.⁸⁸ If the corporation fails to comply and cannot satisfy all resulting claims, the officers would be responsible for the remaining liability. These individuals would thus have the incentive to ensure that the corporation continuously complied with all relevant laws and properly assessed and internalized all risks. Most significantly, those individuals could make sure that the corporation maintained adequate insurance to cover all liabilities. The potential for personal liability would improve corporate compliance, much as I suspect it does in the tax area.⁸⁹

86. Cost internalization will raise the cost of the product to the proper level, which may eliminate some tort costs in bankruptcy in several ways. First, some of the tort victims may have been paid (presumably from the extra price paid by the product's buyers) long before bankruptcy occurs. Second, the higher cost may force some buyers to substitute a different product. Third, the higher price may force the producer to develop a safer product. Both the second and third possibilities may avoid the injury associated with the problem product.

87. I realize that defining the parameters of this liability will take some thought. The duties and corresponding liabilities that legislators impose on corporate officers will have to be carefully considered and precisely expressed.

88. Some laws already extend liability to corporate officers. In its present form, however, CERCLA places liability on an "owner or operator" and also on those who arrange for disposal or actually dispose of the waste. 42 U.S.C. § 9607(a)(1)-(4) (1988). To the extent any court has thus far imposed liability on corporate officers, it has done so because, under the facts of the particular case, that person's acts brought him or her within the CERCLA definition of owner, operator, arranger, or transporter. See generally Lynda J. Oswald, *Strict Liability of Individuals Under CERCLA: A Normative Analysis*, 20 B.C. ENVTL. AFF. L. REV. 579 (1993); Lynda J. Oswald & Cindy A. Schipani, *CERCLA and the "Erosion" of Traditional Corporate Law Doctrine*, 86 NW. U. L. REV. 259 (1992). See also Kathryn R. Heidt, *Liability of Shareholders Under the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA")*, 52 OHIO ST. L.J. 133, 137-48 (1991).

89. But even in the tax area, perfect results are hard to achieve. In the federal income tax area, for example, personal liability for withholding taxes undoubtedly increases corporate compliance, but cannot ensure it in every case.

Second, placing full or partial liability on shareholders would encourage internalization. Expanding shareholder liability for tort and other nonconsensual debt has been suggested and debated.⁹⁰ Requiring shareholders to disgorge profits or gains received from a corporation that improperly disposed of toxic substances is another suggestion.⁹¹

Third, tort and environmental claims could be given priority over all obligations, including consensual secured claims.⁹² Priority could be given outside the bankruptcy system—not just inside bankruptcy. Once inside bankruptcy, environmental obligations and other extraordinary obligations could be afforded a very high priority under § 507. Chapter 11 could require that they be paid on the effective date of the plan, like administrative obligations and most other priority obligations.⁹³ At a minimum, they could be treated like tax claims and paid over six years.⁹⁴ Assigning these obligations a high priority in bankruptcy, in combination with assessment of personal liability against corporate officers, would create strong incentives for the officers to ensure that the corporation's environmental obligations are met.

Potential criminal penalties can further promote compliance. The current scheme adopted by the federal sentencing guidelines for determining corporate criminal penalties encourages compliance with environmental statutes and creation of safety systems by reducing penalties for those corporations that have a system of compliance and safeguards in place and

90. See Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879 (1991) (suggesting shareholder liability for nonconsensual obligations on a pro rata basis according to the amount of ownership in the firm); Janet C. Alexander, *Unlimited Shareholder Liability Through A Procedural Lens*, 106 HARV. L. REV. 387 (1992) (pointing out the procedural obstacles to Hansmann and Kraakman's thesis); Teresa A. Gabaldon, *The Lemonade Stand: Feminist and Other Reflections on the Limited Liability of Corporate Shareholders*, 45 VAND. L. REV. 1387 (1992); Joseph A. Grundfest, *The Limited Future of Unlimited Liability: A Capital Markets Perspective*, 102 YALE L.J. 387 (1992); David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565 (1991); Robert B. Thompson, *Unpacking Limited Liability: Direct and Vicarious Liability of Corporate Participants for Torts of the Enterprise*, 47 VAND. L. REV. 1 (1994).

91. See, e.g., Kathryn R. Heidt, *Corrective Justice From Aristotle to Second Order Liability: Who Should Pay When the Culpable Cannot?*, 47 WASH. & LEE L. REV. 347, 358-65 (1990) (arguing that secured creditors, as "gainers," must disgorge their gains).

92. See Heidt, *supra* note 10; LoPucki, *supra* note 8; Heidt, *supra* note 91; see also Painter, *supra* note 8.

93. See 11 U.S.C. § 1129(a)(9)(A), (B)(ii) (1988).

94. 11 U.S.C. § 1129(a)(9)(C) (1988).

have designated an individual responsible for compliance.⁹⁵

Another possible method to encourage internalization is to allow recovery not just for actual injury but also for increased *risk* of injury. A requirement that companies compensate potential victims for the increased risks caused by the companies' activities will lead to better cost internalization. For example, the asbestos manufacturers would not have been able to wait decades before they had to start compensating victims if the potential claimants could have sued based on the increased risk of lung problems. Rather, these companies would have had to pay as they were producing the harmful product. This solution, however, presents enormous practical problems, including assessment of the risks and the likelihood and magnitude of the potential harm, and the possibility of windfall gains. These problems can be overcome, at least in part, by requiring companies that create increased risks to pay amounts equal to their projected liability, but to hold the funds in trust until the victims are identified and in need of compensation. This practice will assure that the victims who need compensation receive it while others, who are not actually harmed, do not receive a windfall.⁹⁶

C. *Part 2: Continuing to Address Extraordinary Harms in Bankruptcy*

Since costs will never be perfectly internalized, we still need to address the question of how to deal with extraordinary harms in bankruptcy. Any solution must determine, from a normative perspective, which obligations will be brought into the bankruptcy system. Once those determinations are made, we can resolve the technical details of the definitional and the timing issues in a way that will effectuate the optimal result. In general, I conclude that (1) equitable as well as legal obligations should be included within the bankruptcy process, and (2) the bankruptcy process should distinguish clearly between past and future events and obligations. It should discharge only those obligations that are based solely on past acts and for which the postbankruptcy entity would not be liable.

The fundamental policies underlying the bankruptcy laws are currently being debated. Some commentators believe that bankruptcy serves as an

95. See Ilene H. Nagel & Winthrop Swenson, *The Federal Guidelines for Corporations: Their Development, Theoretical Underpinnings, and Some Thoughts About Their Future*, 71 WASH. U. L.Q. 205 (1993).

96. There is still the contention that the anxiety of being exposed to increased risk should be considered a compensable injury. Under this viewpoint, persons who are exposed to, but not actually harmed by, toxic substances may still be entitled to some compensation.

efficient mechanism through which creditors can recover from a debtor.⁹⁷ Others believe that a bankruptcy system does more than serve creditors. They argue that bankruptcy distributes the impact of the debtor's widespread default.⁹⁸ Still others take a more normative approach and argue that bankruptcy should serve community goals. In fact, some scholars would go so far as to say we should overhaul our bankruptcy laws with the interests of the community in mind.⁹⁹ No matter which view we take, we still must decide how to treat the new extraordinary liabilities. Do we categorize the new liabilities as obligations that arose in the past in order to bring them into the bankruptcy proceeding? Or do we treat them as obligations that continue to arise in the future?

I will examine these questions first in the context of products liability claims, and then in the context of two environmental obligations, the obligation of ongoing compliance and the obligation to clean up.

1. Removing the Distinction Between Equitable and Legal Obligations

Distinctions about which obligations should be subject to the bankruptcy process should not be based on their character as legal or equitable obligations. As explained below, such distinctions are artificial and result in similar creditors receiving dissimilar treatment. Accordingly, the definition of "claim" should be broadened to include all obligations, legal and equitable. The determination of which obligations will be included in the bankruptcy system can then be made more accurately using the timing requirement (i.e., when the obligation came into existence).

Currently, an obligation that is purely equitable and for which money cannot be substituted is outside the definition of "claim."¹⁰⁰ This definition does not take into account any element of time. While some obligations that might be characterized as equitable obligations *should be* nondischargeable, such as the obligation to comply on an ongoing basis with all regulations, there are other equitable obligations, such as certain specific performance obligations, for which discharge is acceptable. The proper distinctions can be drawn (i.e., the nondischargeability of the former obligations) based on the timing issue rather than the definitional issue.

97. See JACKSON, LOGIC, *supra* note 3, at 7-19; Baird, *A World Without Bankruptcy*, *supra* note 3, at 183.

98. See Warren, *supra* note 3, at 787.

99. See Karen Gross, *Taking Community Interests into Account in Bankruptcy: An Essay*, 72 WASH. U. L.Q. 1031 (1994).

100. See *supra* notes 16-17 and accompanying text.

The definition of "claim" should be broadened so that discharge does not depend solely on the characterization of a claim as legal or equitable. However, to assure ongoing compliance with all laws and regulations, only those claims that "arose" before a specified time can be made dischargeable.

An obligation that is purely in the past should be dischargeable, whether equitable or legal in nature. For example, assume that Debtor has agreed to sell her Chagall painting to Buyer.¹⁰¹ Buyer prepays the \$100,000 purchase price, but Debtor fails to turn over the painting and files bankruptcy. In some states Buyer has the right to specific performance, because the property is unique. If, under applicable state law, Buyer has a right to specific performance and cannot be forced to take money as an alternative remedy, the obligation is not a "claim" under the Bankruptcy Code and will not be discharged.¹⁰² If Buyer is permitted to enforce its right to specific performance, Buyer will have its obligation satisfied in full while other creditors will receive something less. Holding that the obligation is not a "claim" determines the priority of Buyer's obligation—Buyer gets paid in full, others get less.

One of the primary goals of bankruptcy is to provide for equal treatment of similar creditors. In the above example, both Buyer and the other creditors were owed general unsecured obligations. One group of creditors should not be preferred over another merely because of the definition of "claim." Therefore, the definition of claim should be broadened to take into account both legal and equitable obligations. We can then use the timing element to solve the problem of determining which obligations should be taken into the bankruptcy process and which should not.

2. *The Products Liability Problem*

How do we treat those who will be injured in the future due to a past act of the debtor—an act that is completed in the past and will not be repeated in the future? I premise my answers to this question on the belief that all bankruptcy proceedings should, at a minimum, maximize recovery for the

101. This hypothetical is borrowed from a similar one in BAIRD & JACKSON, CASES, *supra* note 10, at 187.

102. In some states Buyer may be forced to accept money and does not have the right to recover the painting through specific performance. In those states, Buyer has a claim within the meaning of the Bankruptcy Code. The result will, therefore, be different from state to state depending on the remedies available in such a case. Congress recognized that different results would be reached on this issue in different states. See 124 CONG. REC. 32,393 (1978) (statement of Rep. Edwards); *id.* at 33,992 (statement of Sen. DeConcini). Thus, the view taken here directly conflicts with the legislative history.

existing claimants and treat similarly-situated creditors similarly. In the context of individual debtors, bankruptcy law should also provide a fresh start. I think that most will find these goals noncontroversial.

To analyze this issue, we can imagine a situation in which a debtor manufactured televisions in the past and, due to a defect in production, televisions are now exploding; or consider again the airplane manufacturer which in the past manufactured so many parts and products that some are sure to be defective and cause injury in the future. Assume the manufacturer files a Chapter 11 proceeding.

First, in the bankruptcy context, we should separate the past from the future. All of the debtor's past assets, including any going-concern value, should be used to pay obligations that arise out of those past activities. This process is precisely what happens in a liquidation. A reorganization is simply a form of liquidation that allows the corporation to continue in business in order to preserve the going-concern value of the business and to ensure that the claimants get the full value of the firm. We should think of a reorganization as a liquidation with the value of the corporation being distributed through the plan of reorganization to the claimants. In a liquidation, there is no postbankruptcy entity that can be sued for old debts. In a reorganization, the new entity also should be free of old debts. It should be responsible only for new liabilities that arise due to postbankruptcy activities. Otherwise, its ability to reorganize successfully will be jeopardized.¹⁰³ Thus, state rules of successor liability should be ignored to the extent that they are inconsistent with the policy goals of bankruptcy law.

Second, we should treat similar creditors similarly. If we include only those victims who have already been injured, claimants injured by the very same act (the design or manufacture of a defective aircraft, for example) are treated differently depending on when the injury occurs. One may be paid in part while another is paid in full or not at all. Consider first the example of a debtor that is being sold as a going concern to another corporation. In a state in which the successor corporation is held liable for the future injuries, the future claims will be paid in full and the present claimants will receive less. The purchaser will discount the purchase price by the amount of the anticipated future liability (and associated costs and legal fees). The purchaser will discount the price because it must pay the future claims as they arise. Consequently, the present claimants, and other

103. See Heidt, *supra* note 10, at 204.

creditors of the debtor, will receive less, because the purchaser discounted the purchase price paid to the bankruptcy estate, from which the bankruptcy distribution will be made to the past creditors.

If, on the other hand, successor liability does not attach, the purchaser will pay more for the corporation. The future claimants will recover nothing and the present claimants will recover more—more than the future claimants recover and also more than the present claimants would recover under a system of successor liability. The recovery of the two groups is unequal. Similarly, if the debtor is not going to be sold as a going concern but is reorganizing, the proponent of the plan of reorganization will have to assess the debtor's future liability, ascertain the likely amount of the future claims, and then take them into account in determining how much to distribute to the present creditors.¹⁰⁴

To treat the two groups of similar creditors similarly, the future victims must be brought into the bankruptcy proceeding. By allowing for discharge of these claims, the bankruptcy system would ensure that the full price will be paid for the corporation. That is, the price that is paid will represent the value of the firm without the tort obligations, because these obligations will be discharged rather than transferred with the firm. This price then will be divided evenly among those who were or will be injured by the debtor's past negligent act. This result is fair in that it treats similar creditors similarly.

Virtually every bankruptcy case may encounter unknown future claims that arise out of a debtor's past activities. The past activities will give rise to future injuries when a television explodes or a plane crashes in the future due solely to a preconfirmation defect. But these future claims must be paid from past assets. To ensure that these claims will be adequately accounted for, a review must be made of the debtor's business activities in every case. Future liabilities may vary widely depending on the debtor's activities. In some cases the expected future claims may be small. But if the debtor was involved in a manufacturing activity, there may be many future claims. Similarly, if the debtor was involved in an activity known or suspected to be dangerous or harmful, a substantial number of future

104. Successor liability is a developing area of law. It may be difficult to determine whether none, some, or all of the future claimants will be able to recover under the doctrine of successor liability. Consequently, it will be difficult for any prospective purchaser (or the reorganizing debtor) to anticipate the future claims and set an appropriate price for the debtor.

claims are likely. Funds can be set aside to pay the future liabilities,¹⁰⁵ and if necessary, a representative for future unknown claimants should be appointed.

Finally, in the case of the individual debtor, these future claims should be dealt with in bankruptcy to give the debtor the appropriate discharge. An individual's liabilities should also be divided into past obligations, which should be discharged, and future obligations, which should not. Bankruptcy in the individual context has been analogized with death.¹⁰⁶ If the debtor dies, whatever obligations existed at the time of her death, and whatever obligations will arise irrespective of her death, are discharged. The only obligations that are not discharged are those that are new—that are due to a postbankruptcy act—*because the debtor is still alive*. Consider two examples. First, a debtor drives through a red light and injures a pedestrian a year after her bankruptcy discharge; the new liability is not discharged. Second, the debtor made a defective television before bankruptcy that explodes one year after bankruptcy; that obligation is discharged. In the second case, if the debtor had died, the injury still would have occurred because it was based upon a past act. But the former obligation would not have arisen had the debtor died. Bankruptcy discharges those obligations that would come into existence even if the debtor dies, i.e., those that will arise due to the debtor's past acts.

3. *Obligation to Take Corrective Action*

A more difficult question is whether the reorganized debtor must clean up a site that it continues to own. An analogous question in the mass tort context is whether the debtor must take all of the asbestos out of existing buildings. The question becomes still more complicated if the debtor does not own the buildings. To what extent must a manufacturer recall a product that has the capacity to cause great harm in the future? In this subpart, I consider the question from two perspectives: (1) the debtor who needs the property to reorganize, and will remain the owner or operator of the property after the reorganization is complete, and (2) the debtor who no longer needs the property and who will not be the owner or operator of the contaminated property after the reorganization.

105. There might be a point at which the costs of providing for the future are greater than the potential recovery. See, e.g., *Locks v. United States Trustee*, 157 B.R. 89 (W.D. Pa. 1993). While it might be inefficient to set funds aside for future claimants, those claimants should still be represented to ensure they have a appropriate voice in the bankruptcy proceeding.

106. BAIRD & JACKSON, *CASES*, *supra* note 10, at 193.

The cleanup obligation includes both an element of the past, the act that caused the contamination, and two elements of the future, the contamination remaining on the property and the possibility that the contamination will spread to additional property. This dichotomy complicates the question of which extraordinary obligations should be discharged. In the environmental context, if the debtor needs the property to reorganize it faces a problem: CERCLA requires the current owner of contaminated property to clean up—period.¹⁰⁷ The magnitude of the cleanup, however, may destroy any possibility of reorganization, and some may argue that the debtor should be able to discharge this obligation so that the company can be reorganized.

For several reasons, however, the debtor should be required to clean up if it continues to own the property. First, to discharge the obligation would favor those in bankruptcy over those outside of bankruptcy. Two companies in the same business would be given different treatment: one forced to clean up and the other not. Each is responsible to clean up under current law. Yet if the debtor receives a discharge of the obligation, it is being given relief from a postreorganization obligation. It gains a competitive advantage beyond merely discharging a debt.¹⁰⁸

Second, in a reorganization, the debtor's assets are in essence being "sold" to the creditors. The assets are the debtor's going-concern value. Its going-concern value includes future expenses of bringing the land into compliance as well as future profits. Another way to consider the problem is to again assume that we have a purchaser for the property. If the entire company were sold as a unit to the highest bidder, the buyer would discount the purchase price by the anticipated cleanup cost. The buyer would take into account the liability it would have as the new owner and reduce the price accordingly. The result in a bankruptcy reorganization should mirror this result: the "price" should be "reduced" inside the

107. 42 U.S.C. § 9607(a)(1) (1988). State law may also require cleanup or reclamation.

108. Some scholars believe that giving the debtor a competitive advantage is far outside the bounds of what bankruptcy law should do. JACKSON, LOGIC, *supra* note 3, at 152-53; BAIRD & JACKSON, CASES, *supra* note 10, at 573-74. On the other hand, simply discharging the debtor's past debts can give the debtor an advantage. This result is an "advantage" of bankruptcy that we find acceptable. After all, in theory at least, the reorganization is for the benefit of the creditors. They receive more than they would in a liquidation. They are now the owners of the firm if they were not paid in full. (I say this in theory, because we know that the shareholders' power to force a valuation gives them substantial negotiating power, and they often end up with at least some equity in the reorganized company even when it is insolvent.) LoPucki & Whitford, *supra* note 3, at 161. The reorganized firm has the advantage of a reduced debt load, but the firm is owned by its former creditors, who gave up their prepetition claims in return for a share in the company.

bankruptcy reorganization by subjecting the reorganized debtor to the liability.¹⁰⁹

Third, there is the possibility of future harm. If the property is not cleaned up, it will cause injury in the future. Any injury that occurs as a result of future contact with the property would be a postdischarge injury and would not be dischargeable. However, future injury can be avoided by cleaning up now. Cleaning up in the present is likely to cost far less than compensating victims in the future, even when we take into account the time value of money.¹¹⁰ Thus, for efficiency reasons, debtors should clean up earlier rather than later.

The clearest way to look at the obligation to clean up is to break it into two parts. One part is the prepetition obligation to clean up based on the debtor's status as a prepetition owner or operator of the site. The other part is an obligation to clean up that is based the debtor's status as the current owner or operator.¹¹¹ While the first obligation is discharged, the second is not. To state the concept in still another fashion: the liability runs with the land.

For the most part, bankruptcy law respects nonbankruptcy law. Nonbankruptcy law creates the underlying obligations of the debtor—the obligation to pay back a loan, the obligation to compensate a victim for a tort, the obligation to clean up. We generally do not allow bankruptcy law to change a nonbankruptcy law entitlement *unless* that entitlement conflicts with bankruptcy policy.¹¹² Thus, to determine whether we should respect the cleanup obligation in bankruptcy or whether we should be able to change it depends on one's view of bankruptcy policy.

Bankruptcy separates the past from the future. In a liquidation, it takes

109. To further analogize the situation using a purchaser: if the debtor sold the property, the purchaser would discount the price to account for the cleanup liability. The debtor in effect pays for the cost of cleanup by receiving the discounted value. This cost is passed on to the claimants in the bankruptcy who receive less than if the purchaser was not responsible for the cleanup. If similar treatment of creditors is the goal, the result should not change when the debtor keeps the property. Accordingly, the liability should not be discharged.

110. While I realize we need empirical data to support this hypothesis, Congress assumed that cleanup was cheaper than compensating future victims for injuries resulting from unremediated contamination. See H.R. REP. NO. 1016, 96th Cong., 2d Sess., pt.1, at 20 (1980), *reprinted in* 1980 U.S.C.C.A.N. 6119, 6123.

111. One court has accepted this view of the cleanup obligation of a reorganized debtor that continued to own the contaminated property. *In re CMC Heartland*, 966 F.2d 1143, 1146 (7th Cir. 1992).

112. *Butner v. United States*, 440 U.S. 48 (1979). See generally JACKSON, LOGIC, *supra* note 3, at 21-27; BAIRD & JACKSON, CASES, *supra* note 10, at 43-55.

the debtor's past assets to pay its past creditors. In a reorganization, the going-concern value of the debtor's past assets is used to "pay" the creditors. Environmental law creates a continuing obligation: it continues the obligation to clean up by requiring the current owner or operator to remediate existing contamination. This difference raises a question: Does the environmental law actually "conflict" with bankruptcy law?

To the extent that a conflict exists between bankruptcy law and state law, the Supremacy Clause of the United States Constitution requires that bankruptcy law control. Some state environmental laws impose a cleanup obligation. These laws could be subject to a possible Supremacy Clause challenge in a bankruptcy proceeding. If the environmental law is a federal statute, it can be attacked as inconsistent with the Bankruptcy Code.

Consider a situation in which the debtor contaminated property in the past. Traditional timing rules look at when the debtor committed the acts that gave rise to the obligation, and would classify this obligation as having arisen in the past.¹¹³ However, current environmental law creates a *continuing* obligation by placing the cleanup obligation on the current owner or operator. It thus keeps the obligation alive—the debtor must clean up if it continues to own the property. In certain situations, state laws imposing a continuing obligation on debtors have been held to conflict with the bankruptcy laws. Such holdings allow the obligations at issue to be discharged. For example, in *Perez v. Campbell*,¹¹⁴ a state statute provided that driving privileges could be restored after an automobile accident only when the tortfeasor paid the tort judgment. The United States Supreme Court held that the statute was unconstitutional to the extent that it conflicted with bankruptcy law, which had discharged the debtor from the obligation.

One can distinguish the cleanup obligation, however. When the property is allowed to remain contaminated it poses a hazard. It can cause further additional injury. Requiring cleanup does more than satisfy an existing obligation; it avoids further additional obligations that will result from the ongoing contamination. Thus, the environmental laws requiring cleanup do more than continue a past obligation. They serve the additional purpose of avoiding future harm. Accordingly, even if they "conflict" with bankruptcy law, they should not be set aside as inconsistent with bankruptcy law.

Thus, when the debtor continues to own or operate the contaminated

113. See BAIRD & JACKSON, CASES, *supra* note 10, at 157-58.

114. 402 U.S. 637 (1971).

property and current nonbankruptcy law requires the debtor to act, the debtor should be required to act. Liabilities arising from the failure to do so, from cleanup liability to compensation for future injuries, would be assertable against the reorganized debtor.

If the debtor does not continue to own or operate the property, the result is different. The cleanup obligation, and any obligations that arise in the future, should be discharged. The situation is similar to the products liability cases. Parties that are not owners or operators have no ongoing obligation to clean up the property.¹¹⁵

One could argue, however, that the liability of the nonowner not only arose in the past, but also continues into the future so long as the property remains contaminated. This continuing liability could be based on two grounds. First, the continuing contamination will cause a postbankruptcy liability that could be asserted in the future. Therefore, the cost to avoid the liability, i.e., the cost of cleanup, is also postbankruptcy. Second, allowing the property to remain contaminated and to expose others to potential harm is a new wrongful act. That is, the failure to clean up is a new act on which liability can be based. The new act happens every day into the future postbankruptcy. Therefore, the cleanup is also a postbankruptcy liability for nonowners.¹¹⁶ This result is inconsistent with the principles discussed earlier under the products liability situation. It fails to separate the past from the future and it treats similar creditors unequally. Therefore, the nonowner/nonoperator should be discharged from the prebankruptcy environmental cleanup liability.

4. *The Obligation of Ongoing Compliance*

The two problems discussed above raise issues that can be addressed by applying noncontroversial policies of bankruptcy law. More controversial policies could also be used, however. For example, one might want to consider the effect that forcing cleanup will have on the employees of a company. To consider a few of the more controversial policies of bankruptcy law, this subpart considers whether a debtor must obey all applicable laws during and after reorganization.

An obligation that, at first, seems easy to categorize is the obligation of the debtor continuing in business to comply with environmental regulations.

115. Thus, the court reached the incorrect result in *Torwico Elec., Inc. v. New Jersey Dep't of Envtl. Protection*, 8 F.3d 146 (3d Cir. 1993), *cert. denied*, 114 S. Ct. 1576 (1994), discussed *supra* notes 74-75 and accompanying text.

116. For further discussion of this concept, see Heidt, *supra* note 10, at 182-86.

An ongoing obligation not to pollute in the future is currently viewed as nondischargeable. In some cases, however, the obligation not to pollute in the future can affect the ability of the corporation to reorganize. Compliance can be costly. If the goal is to maximize overall wealth (both for the shareholders in the corporation and for society in general), we would engage in a cost/benefit analysis, weighing the monetary and social costs of compliance against the benefits of reorganization in a given case.

For example, consider a debtor whose manufacturing plant contains a pipe that slowly leaks a toxic substance into the ground. To dig up and repair this pipe will cost the debtor \$1,000,000. If the leak continues, the additional substances added to the already-contaminated ground will have almost no additional detrimental effect. The debtor predicts that for each additional \$100,000 in operating costs, it will have to eliminate two jobs for two years. Should the debtor be forced to repair the pipe? While this particular question is presented in a rather simplistic form, answers will vary depending on one's view of bankruptcy law. Some believe that an operating debtor must comply with all laws and regulations while it operates.¹¹⁷ They reason that because nondebtor companies must comply with all laws and regulations, and a nondebtor in a similar situation would have to repair the leak, the debtor should not gain a competitive advantage because of bankruptcy. Therefore, the debtor must be held to the same compliance standards as its competitors; its obligation to repair the leak cannot be discharged.

However, those who view bankruptcy as a means to distribute the effects of the debtor's default might argue that we should at least look at the effects of compliance. Which interests are served by compliance and which are hurt? Because little additional harm will result, some might say that the debtor should not be forced to fix the pipe. Rather, we should favor the employees over the land—especially since there will be no significant additional contamination.

Some commentators might allow bankruptcy judges to make these decisions. For example, Professor Gross might suggest that we establish a set of standards within which a judge could operate.¹¹⁸ The debtor might be required to comply with an ongoing environmental regulation

117. JACKSON, LOGIC, *supra* note 3, at 172-81. Here, we also have a § 959(b) problem. 28 U.S.C. § 959(b) (1988) (providing that a trustee or debtor-in-possession must operate property in his possession "according to the requirements of valid [state] law"). But by its terms, § 959(b) only applies to the time during which the debtor is reorganizing, not after it is reorganized. *Id.*

118. See Gross, *supra* note 99.

only if its failure to do so will cause additional actual harm. The additional actual harm might have to be quantifiable, and it might have to be significant. Those who support such an approach might say that the judges could “balance” the interests of the various parties to the proceedings. The judge could take the identity of the interests into account. If the dispute is merely between creditors owed money and the government, the judge could order compliance. If, however, compliance will completely stall a reorganization and the stalled reorganization will detrimentally affect the local community, employees, and other persons who are not technically “creditors,” then the bankruptcy judge may review the situation and allow the debtor to postpone compliance.

Bankruptcy judges should not make these choices. First, the question of how to distribute the effects of a debtor’s default is not an appropriate question for bankruptcy judges. It is a question currently addressed by the legislature. Although some might prefer that markets or judges make these decisions, the legislature is the body that establishes the groundwork for allocating the effects of widespread default. The legislature sets the default rules against which the market and the judges operate. The rules are set in the Bankruptcy Code.

The decision to allocate the losses caused by the debtor’s widespread default is a distributive question. In deciding distributive issues, direct payments are favored because the public can trace the use of its tax dollars. It is preferable to see the government lend Chrysler millions of dollars than to hide it in relief from tax liability or environmental cleanup costs or tort liability.¹¹⁹ In the event we want to create jobs, Congress can create jobs by direct payment or subsidy. We can see where the money is coming from and where it is going. Irrespective of one’s view of bankruptcy policy, the answer must come from the legislature, not the courts.

Second, to allow the debtor to operate in a state of noncompliance with environmental regulations also sends the wrong set of incentives to the marketplace. Such a policy sends the message that a company can circumvent the law by contaminating property, filing bankruptcy, and continuing to operate in violation of safety standards, because no one will risk putting employees out of work by closing down the debtor. In general, giving a court the power to allow a firm to disregard existing environmental rules effectively gives the court the power to grant that firm a

119. Arguably, hidden subsidies are inefficient, inappropriately shift risks from one group to another, and raise moral hazard problems. See, e.g., Cheryl D. Block, *Overt and Covert Bailouts: Developing a Public Bailout Policy*, 67 IND. L.J. 951 (1992).

competitive advantage in the marketplace. Should the government be rewarding inefficient firms with special licenses to pollute? I think not.

Third, bankruptcy judges, indeed any judge, might value jobs more than a whole variety of other interests. As a result, inefficient businesses that would otherwise be declared dead might be allowed to continue to operate. We do not keep businesses alive just because they employ people. Indeed, this "employee-based" argument (which has gained recent popularity¹²⁰) may be short-sighted. We do not know the full effect of saving a job. For example, for every job we save in the inefficient firm we may (or may not) be eliminating a similar job with a competitor. That is, if the debtor does go out of business, one of its competitors may pick up the slack, hire more employees, and expand its business. Because the second firm is presumably more efficient (it did not file bankruptcy at least), should we not be favoring the nonbankruptcy competitor?¹²¹ Emotional arguments about "lost" jobs often have little to recommend them other than favoring a local community over the more distant one of the competitor. Judges and litigants lack the analytic perspective necessary to address this question fully. Local judges are not the ones who should make the choices between such compelling interests as local jobs and the environment.

VI. CONCLUSION

The very concept of debt or obligation in bankruptcy can be expanded or contracted to bring in or leave out different obligations. We could even expand the concept so far as to include the interests of employees or the local community or others who do not currently have an official voice in bankruptcy. In this paper I do not address the question of who, in the entire universe that bankruptcy affects, should have a voice. That subject is being addressed by others.¹²² Rather, I have attempted to resolve the question of how to treat certain obligations that can arise against a debtor but that do not now fit squarely within the bankruptcy system. These are real obligations, yet because bankruptcy law has not kept pace with

120. See, e.g., Karen Gross, *Justice Thurgood Marshall's Bankruptcy Jurisprudence: A Tribute*, 67 AM. BANKR. L.J. 447 (1993).

121. This argument is also somewhat simplistic since we cannot possibly know without substantial empirical research how many jobs in efficient firms are lost by keeping inefficient firms afloat. Considering the point further, for example, one might argue that because start-up costs are often prohibitive, not every business that closes will be replaced elsewhere in the economy. Thus, the jobs of the closed business truly may be lost.

122. See *supra* note 3.

nonbankruptcy law in recognizing these obligations, they do not fit within the bankruptcy model and have proved difficult to analyze in the bankruptcy context.

The resolution of how to treat these new obligations goes beyond deciding how to handle mass tort or environmental obligations in the bankruptcy system. Whatever our answer to those problems is today, we may find a still more complex problem tomorrow. A complete answer to the problem of extraordinary harms must resolve how we should treat these liabilities as a society and who should ultimately pay for them.

Yes, bankruptcy is in trouble—but not only because more efficient alternatives might exist, or because Chapter 11 takes too long, or because we need separate systems for small and large business. It is in trouble because it lacks a consistent theory of debt. Before we scrap or revise Chapter 11, we need to rethink the concept of debt. Not only do the contours of these new obligations affect Chapter 11 proceedings, they affect all bankruptcy proceedings.

Changes may be based on efficiency, fairness, a “communitarian” view, a market approach, or a messy approach—one that takes many of these factors into consideration. But the bottom line is that obligations have changed in our society and we need to change the bankruptcy paradigm of debt to keep pace. Changing the paradigm means first eliminating the distinction between legal and equitable obligations, and second, including in the paradigm those liabilities arising out of a past act of the debtor. New postbankruptcy liabilities should not be covered even though prebankruptcy acts gave rise to the liability. That is, we need to distinguish between obligations that arose out of prebankruptcy events and have no independent basis for postbankruptcy liability (e.g., the typical mass tort case or the cleanup obligation of one who *previously* owned the contaminated property) from those obligations that originally arose out of prebankruptcy obligations but have a postbankruptcy basis for new liability (e.g., when the debtor owns the contaminated property postbankruptcy). The former obligations are subject to the bankruptcy process and are discharged, while the latter obligations are not. By using the trust mechanisms and appointing representatives for future claimants, problems of due process and problems resulting from the lack of perfect information can be resolved.